



# Public Utility Commission of Texas

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Pat Wood, III  
Chairman

Judy Walsh  
Commissioner

Patricia A. Curran  
Commissioner

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AUG 31 1998

FCC MAIL ROOM

August 27, 1998

Office of the Secretary  
Federal Communications Commission  
1919 M Street, N.W., Room 222  
Washington, D.C. 20554

RE: Notice of Proposed Rulemaking, In the Matters of 1998 Biennial Regulatory Review -  
Review of Accounting and Cost Allocation Requirements, CC Docket No. 98-81;  
United States Telephone Association Petition for Rulemaking, ASD File No. 96-84

Dear Secretary:

Enclosed for filing are an original and nine copies of the Reply Comments of the Public Utility Commission of Texas in the above referenced proceeding.

Thank you for your assistance.

Sincerely,

Stephen J. Davis  
Chief  
Office of Policy Development

Enclosures

cc: Mr. Warren Firschein, Accounting Safeguards Division, Common Carrier Bureau  
International Transcription Services

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**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

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**AUG 31 1998**

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**In the Matters of**

**1998 Biennial Regulatory Review -  
Review of Accounting and Cost Allocation  
Requirements United States Telephone**

**United States Telephone  
Association Petition for Rulemaking**

**CC Docket No. 98-81**

**ASD File No. 96-84**

**REPLY COMMENTS OF THE  
PUBLIC UTILITY COMMISSION OF TEXAS**

**Pat Wood, III, Chairman  
Judy Walsh, Commissioner  
Patricia A. Curran, Commissioner**

**August 26, 1998**

Before the  
Federal Communications Commission  
Washington, D.C. 20554

In the Matters of	)	
	)	
1998 Biennial Regulatory Review -	)	CC Docket No. 98-81
Review of Accounting and Cost Allocation	)	
Requirements United States Telephone	)	
	)	
United States Telephone	)	ASD File No. 96-84
Association Petition for Rulemaking	)	
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REPLY COMMENTS OF THE  
PUBLIC UTILITY COMMISSION OF TEXAS

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## **Executive Summary**

The Public Utility Commission of Texas (Texas PUC) herein provides its Comments to the Federal Communications Commission (FCC or Commission) on the issue of whether to relax its accounting and cost allocation rules.

In Section II, Texas Affiliate Rules, we describe recent activities undertaken by the Texas PUC to address the relationships among local exchange carriers and their affiliates.

Section III addresses the issue of Class A Accounting and CAM requirements for Large Incumbent Local Exchange Carriers. The Texas PUC advocates maintaining rigorous and comprehensive cost allocation and accounting rules for the large LECs. We oppose the reliance on generally accepted accounting principles (GAAP) alone, until there is widespread competition in local telephone markets.

Section IV addresses the issue of streamlining the accounting and CAM requirements for mid-sized ILECs. We agree with the Commission's proposals to simplify the requirements for mid-sized LECs by reducing the number of accounts and the frequency of audits.

Section V addresses the issue of accounting changes for all LECs subject to Part 32 requirements. The Texas PUC generally does not oppose the Commission's proposal to streamline these accounting requirements, with the exception of the proposal to consolidate all nonregulated activities into one account.

Finally, Section VI of these comments responds to opinions expressed in the LEC Coalition white paper.

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matters of	)	
	)	
1998 Biennial Regulatory Review -	)	CC Docket No. 98-81
Review of Accounting and Cost Allocation	)	
Requirements United States Telephone	)	
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Association Petition for Rulemaking	)	
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**REPLY COMMENTS OF THE  
PUBLIC UTILITY COMMISSION OF TEXAS**

**L Introduction**

1. In its Notice of Proposed Rulemaking (Notice), adopted on June 2, 1998,<sup>1</sup> the Federal Communications Commission (FCC or Commission) initiated a rulemaking to review its accounting and cost allocation rules. The Public Utility Commission of Texas (Texas PUC), having been given general regulatory authority over public utilities within our jurisdiction in Texas, hereby submits these Reply Comments on certain issues considered in this proceeding. We also respond to some of the opinions expressed in the "white paper" prepared for several local exchange carriers (LECs) by Arthur Andersen LLP, entitled *Accounting Simplification in the Telecommunications Industry* (LEC Coalition white paper).<sup>2</sup>

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<sup>1</sup> *In the Matter of 1998 Biennial Regulatory Review*, CC Docket No. 98-81, Notice of Proposed Rulemaking, FCC 98-108 (June 2, 1998).

<sup>2</sup> Arthur Andersen LLP, *Accounting Simplification in the Telecommunications Industry* (July 15, 1998). The "LEC Coalition" includes Ameritech Corporation, BellSouth Corporation, GTE Service Corporation, SBC Communications, Inc., and US WEST, Inc.

## II. Texas Affiliate Rules

2. The Texas PUC shares the Commission's interest in affiliate issues. In June 1997, the Texas PUC initiated a new rulemaking<sup>3</sup> to address activities between regulated affiliates and their nonregulated affiliates. In several public workshops and informal meetings<sup>4</sup> with the Texas PUC staff and commissioners, incumbent local exchange carriers (ILECs) were adamantly opposed to any new affiliate rules. Specifically, Southwestern Bell Telephone (SWBT), General Telephone Company of the Southwest, Inc. (GTE), Sprint Corporation, and the Texas Telephone Association (TTA), a trade association representing the majority of Texas ILECs, argued that new rules regarding affiliate relationships were unnecessary because the FCC has sufficient, rigorous, and comprehensive affiliate rules in place, and any additional rules would be regulatory overkill.<sup>5</sup>

3. On July 22, 1998, the Texas PUC staff brought before its commissioners draft rule language to be published for public comment. The Texas Commissioners noted that the proposed rules were intended to serve as a regulatory "stopgap" to the extent that federal rules did not reach intrastate affiliate activities, but decided that market conditions are changing rapidly enough that it would be prudent to wait for several months to see if these stopgap measures continue to

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<sup>3</sup> Project 17549, *Rulemaking to Address Affiliate Activities*, initially applied to both electric and telecommunications utilities. In February 1998, the telecommunications portion of the rule was severed into a separate project, Project 18811, and Project 17549 continued as an electric utility affiliate code of conduct.

<sup>4</sup> The Texas PUC staff held workshops to discuss affiliate issues and draft rule language on December 18, 1997, and February 11, 1998. Informal discussions were held with any interested party requesting a meeting throughout the life of the project.

<sup>5</sup> Texas Telephone Association, *Presentation to the Public Utility Commission's Workshop on Affiliate Safeguards* (February 11, 1998); GTE, *Issues to Be Addressed in Rulemaking on Affiliate Relationships* (January 15, 1998) and *Initial Comments* (July 25, 1997); SWBT, *Informal Comments of Southwestern Bell Telephone* (January 28, 1998).

be needed.<sup>6</sup> Therefore, rather than moving forward with the proposed rules, the Texas PUC indefinitely postponed action on the project. Chairman Pat Wood expressed the opinion that the outcome of SBC Communications' court challenge<sup>7</sup> of the constitutionality of §§ 271-275 of the federal Telecommunications Act of 1996 (FTA) will have an impact on its decision to reactivate the rulemaking.<sup>8</sup> Our decision to postpone action on this rulemaking must be reconsidered if the existing FCC affiliate and cost allocation rules are eliminated or dramatically scaled back.<sup>9</sup> We are very concerned that significant relaxation of such rules at this time could have significant negative consequences on the development of competition in the State of Texas, and urge the Commission to use extreme caution in revising its rules. The following sections provide more detailed comments regarding issues addressed in the Notice and the LEC Coalition white paper that are of specific concern to Texas.

### **III. Class A Accounting and CAM requirements for Large Incumbent Local Exchange Carriers.**

4. Commissioner Harold W. Furchtgott-Roth requests comments on SBC Communications' suggestion that the Part 32 rules be eliminated altogether in favor of Generally Accepted Accounting Principles (GAAP).<sup>10</sup> As noted in the introduction to the Notice, this

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<sup>6</sup> Texas PUC Open Meeting Transcript at 143-154 (July 22, 1998).

<sup>7</sup> *SBC Communications, Inc., et al., v. Federal Communications Commission, et al.*, No. 98-10140, United States Court of Appeals for the Fifth Circuit.

<sup>8</sup> Texas PUC Open Meeting Transcript at 143-154 (July 22, 1998).

<sup>9</sup> The Texas PUC further notes that it already has rules in place that substantially rely on existing FCC rules. For example, PUC SUBST. R. 23.12 requires Texas telephone utilities to maintain its books and records and file annual reports and cost allocation manuals in accordance with FCC requirements. To the extent significant changes are made to the FCC rules, the Texas PUC will have to give careful reconsideration to our existing accounting rules to ensure that they are sufficiently rigorous.

<sup>10</sup> Notice, Separate Statement of Commissioner Harold W. Furchtgott-Roth.

review is conducted pursuant to Section 11 of the Communications Act of 1934, as amended, which requires the FCC to determine whether the regulations applicable to providers of telecommunication services are no longer in the public interest due to meaningful economic competition between providers of such service.<sup>11</sup> The Texas PUC believes that the phrase "meaningful economic competition" is key in determining whether the current regulations should be relaxed. The Texas PUC shares the Commission's belief that the present Class A accounting procedures are necessary to monitor the large incumbent LECs as competition begins to develop in local telephony markets.<sup>12</sup> Until there is widespread competition in local telephony markets, any steps toward streamlining the current accounting and cost allocation requirements for large LECs would be very premature.

5. The Texas PUC believes that the less detailed accounting and cost allocation requirements under GAAP, while appropriate for a deregulated industry, would not be suitable for regulating the large LECs. In order to regulate the large LECs in this period of transition from regulation to competition, we believe that regulators must have sufficiently detailed information on affiliate activities to identify the potential cost misallocations that could harm consumers and competition. The less detailed accounting requirements under GAAP would be insufficient to protect the public interest. The Texas PUC concurs with the Commission that the existing Class A accounting procedures provide the level of detail needed to ensure that a carriers' emerging competitive services are not subsidized by the noncompetitive activities.<sup>13</sup>

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<sup>11</sup> Notice, ¶ 1.

<sup>12</sup> Notice, ¶ 6.

<sup>13</sup> Notice, ¶ 6.



6. The Commission requests comments on whether Class A requirements for the largest incumbent LECs should be relaxed.<sup>14</sup> As noted earlier, the Texas PUC believes that the Class A accounting and CAM requirements should be maintained for large LECs until meaningful economic competition is determined to exist. The Texas PUC concurs with the Commission's rationale that the detailed level of accounting allows for more refined cost allocations and identification of potential areas of cross-subsidization given that the largest LECs are likely to conduct more transactions with affiliates engaged in competitive activities than the small and mid-sized companies.<sup>15</sup> The Texas PUC also believes that the FTA created more affiliate requirements which continue the need for detailed accounting related to affiliate activities. In conclusion, as far as oversight of affiliate activities of the largest ILECs is concerned, the Texas PUC believes that the current level of affiliate reporting is necessary.

#### **IV. Streamlining Accounting and CAM Requirements for Mid-sized Incumbent LECs**

7. The Commission requests comments on its tentative conclusion that mid-sized carriers may opt to use Class B accounting<sup>16</sup> and that mid-sized incumbent LECs should be permitted to submit their CAMs based upon the Class B system of accounts.<sup>17</sup> The Texas PUC concurs with the Commission's proposal to streamline the accounting and CAM requirements for mid-sized LECs. The changes, as proposed, will permit the Commission and the Texas PUC to continue to perform our statutorily mandated oversight functions while eliminating unnecessary reporting requirements. The Texas PUC, as a regulator, is cognizant of our duty to carefully

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<sup>14</sup> Notice, ¶ 6.

<sup>15</sup> Notice, ¶ 6 and ¶ 12.

<sup>16</sup> Notice, ¶ 5.

<sup>17</sup> Notice, ¶ 10.

balance the need for particular information with the cost and effort required to produce such information. The changes, as proposed, strike such a balance.

8. Along the same lines, the Commission requests comments on its conclusion that mid-sized incumbent LECs be required to obtain an audit of their cost allocation data every two years instead of annually, and that the required audit be an attest audit, which has significantly less stringent standards of testing, reporting and expression of opinion than the audits currently required.<sup>18</sup> The Texas PUC concurs with the Commission's proposals related to CAM audits of the mid-sized LECs. The proposed changes provide the mid-sized companies with cost relief related to compliance with the current requirements while maintaining the integrity of regulatory oversight by the Commission, as well as state regulators.

#### **V. Accounting Changes for all LECs Subject to Part 32 Requirements**

9. The Commission requests comments on its conclusion that a number of accounts or filing requirements may be reduced or eliminated for all carriers subject to Part 32, not just the mid-sized LECs.<sup>19</sup> Specifically, the Commission seeks comments on the following items:

1. The consolidation of Accounts 2114, 2115, and 2116 into a single account, entitled Account 2114, Tools and other work equipment.<sup>20</sup>
2. The consolidation of Accounts 6114, 6115, and 6116 into a single account, entitled Account 6114, Tools and other work equipment expense.<sup>21</sup>
3. The conclusion that the Commission's interest in ensuring segregation of nonregulated revenues and expenses from regulated revenues and expenses will be served by allowing carriers to combine all nonregulated activities into one account.<sup>22</sup>

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<sup>18</sup> Notice, ¶ 11.

<sup>19</sup> Notice, ¶ 13.

<sup>20</sup> Notice, ¶ 14.

<sup>21</sup> Notice, ¶ 15.

<sup>22</sup> Notice, ¶ 16.

10. The Texas PUC agrees with the Commission's assessment of the impact of items 1 and 2 enumerated above. Consolidation of these related accounts will reduce accounting and reporting requirements while not affecting intrastate operating results. The Texas PUC does, however, oppose the Commission's proposal to aggregate all nonregulated activities into one account. This proposal may jeopardize our ability to acquire necessary information. For example, in Texas, the net contribution from yellow pages (revenues less expenses) traditionally has been used as an offset to the cost of providing local service. Additionally, in the Texas PUC's annual earnings monitoring reports (which all LECs operating in Texas are required to file), the net contribution from yellow pages is included in the reported intrastate operating results for purposes of evaluating each LEC's earnings. The Texas PUC is concerned that if the Commission allows carriers to combine all nonregulated activities into a single account, we will be unable to determine the net yellow page contribution.

11. The Texas PUC is sensitive to the United States Telephone Association's concerns that product-specific information could place carriers at a competitive disadvantage.<sup>23</sup> The Texas PUC proposes to address these concerns by allowing carriers to publicly report such information in aggregate form, but requiring continued maintenance of the information in segregated form.

## **VI. Responses to comments made in the LEC Coalition white paper**

**A. Recommendation that State Commissions be required to justify requests of carriers under competition.<sup>24</sup>**

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<sup>23</sup> Notice, ¶ 16.

<sup>24</sup> It is unclear who the coalition LECs propose state commissions justify requests to or who would rule on whether or not a request is justified, since it appears from the referenced statement that they believe the FCC would also have to justify requests for information. Any requirement

12. The Texas PUC strongly opposes the statement that "Similar to the FCC, State Commissions should have to justify requests of carriers under competition."<sup>25</sup> The State statute governing utilities in Texas, the Public Utility Regulatory Act (PURA)<sup>26</sup> grants the Texas PUC the authority to "prescribe the form of books, accounts, records, and memoranda covering information in addition to that required by the federal agency." (emphasis added)<sup>27</sup> Chapter 58 of PURA provides for an election of incentive regulation by LECs. This election allows the utility to be free of traditional rate of return regulation for a period of four years in exchange for an infrastructure commitment.<sup>28</sup> In fact, the BOC and GTOC operating in Texas have both opted into such incentive regulation. Nothing in this provision, however, restricts the Texas PUC from requiring electing companies to provide any information it deems necessary. One specific provision of Chapter 58 requires the Texas PUC to review and evaluate each company making an election under this provision and file a report with the Texas legislature as to whether the incentive regulation should be extended, modified, eliminated, or replaced with another form of regulation.<sup>29</sup> Any federal limitation of the type and amount of information that may be obtained by state commissions will impede our ability to carry out our statutorily mandated obligations.

13. Additionally, the degree of telecommunications competition (and, therefore, regulation) is not consistent among the fifty states. Even within Texas, numerous ILECs continue to be regulated under rate of return regulation while some ILECs enjoy the flexibility of incentive

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that state commissions must justify requests of carriers under competition would put severe time and resource constraints on already taxed commission staffs.

<sup>25</sup> LEC Coalition White Paper at 51.

<sup>26</sup> Public Utility Regulatory Act, TEX. UTIL. CODE ANN. §§ 11.001-63.063 (Vernon 1998) (PURA)

<sup>27</sup> PURA § 14.151

<sup>28</sup> PURA Chapter 58, Subchapter B

<sup>29</sup> PURA § 58.028

regulation. In the case of the latter, the Texas PUC is required to recommend to the Legislature whether or not incentive regulation should continue or be replaced by another form of regulation, *including rate of return regulation*. Therefore, it is premature to conclude that rate of return regulation is an outdated concept. It is imperative that each state commission continue to have the ability to determine the type of information it needs to carry out its regulatory duties.

**B. Proposal to provide information on an "as needed" basis.**

14. The second LEC request we would like to address is the proposal to move away from the current requirement to report information on an annual basis and move toward an "as needed" basis.<sup>30</sup> The LEC paper correctly points out that "needs will change from year to year depending on a number of factors."<sup>31</sup> Information that might not be needed in one reporting period could become critical in a later period as operations, lines of business or the competitive climate change. One tool that we, as regulators, find helpful is the use of trending. We can occasionally gain a better understanding of what is occurring in certain aspects of a utilities' operations by observing trends in certain items or accounts over time. If LECs are allowed to provide information only when requested, there is a good probability that information requested for certain accounts or groups of accounts will not be available in the form required when requested (possibly years later). This would render the use of trending as a regulatory tool "dead" or, at the very least, meaningless.

**C. Who benefits from cost savings?**

15. Our final comments on the coalition LEC white paper address no particular statement or point, but rather a predominant theme running throughout the commentary: the

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<sup>30</sup> LEC Coalition White Paper at 50.

<sup>31</sup> LEC Coalition White Paper at 51.

purported burdensome cost of complying with the Part 32 and CAM requirements and the supposed significant cost savings the LECs could realize absent these requirements. As discussed previously, local exchange markets in Texas are not experiencing widespread competition. It is unclear to us how, under price cap regulation, and absent true competition, rate payers would receive any benefit of the alleged cost savings because LECs have no incentive to pass any of the cost savings through to their customers. Absent price cap regulation, of course, such savings can be flowed through to ratepayers as appropriate.

## **VII. Conclusion**

16. The Texas PUC recognizes the importance of sufficient, rigorous and comprehensive accounting and cost allocation requirements to protect the public interest in this period of transition from regulation to competition. In these comments we have sought to share with the FCC the experience we have gained in regulating the affiliate activities of incumbent LECs in Texas. In addition, we have relayed some concerns we have about the negative consequences of any steps to significantly relax the accounting and cost allocation requirements for large ILECs. We look forward to continuing a productive state-federal partnership to bring the benefits of competition to all consumers as quickly as possible.

Respectfully submitted,

Public Utility Commission of Texas  
1701 N. Congress Ave.  
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August 26, 1998



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